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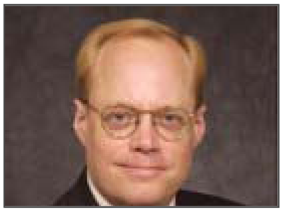

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Apple's Da Vinci Tax Code

Apple is innovative and profitable but may not Think Different after all. That's one conclusion from its tax flap. Senators Levin and McCain claimed Apple skirted U.S. taxes on $44 billion over the last four years. CEO Tim Cook testified that Apple doesn't use gimmicks, yet Apple's tax strategies don't seem too different from many others.

In September 2012, the Senate Permanent Investigations Subcommittee examined tax avoidance strategies of Microsoft and Hewlett-Packard. Much of it is about off-shoring. Oddly, the last five years of IRS crackdowns on offshore income and accounts might make you think ***anything*** offshore is illegal. It isn't, although disclosure and reporting are key.

Individuals and companies face different rules. Individual Americans must pay U.S. tax on their worldwide income. They can claim foreign tax credits for taxes paid elsewhere but can still end up with high U.S. taxes. See 10 IRS Rules For Stress-Free Foreign Accounts. Companies, on the other hand, have many ways to keep money from being taxed in the U.S.

Apple may have put the tax code on display, but few conclusions emerged other than the need for reform. The Senate Permanent Investigations

Subcommittee's report on Apple painted a grim picture. Yet Mr. Cook deflected barbs by putting the burden back on legislators to reform the tax laws that Apple–and many other companies–like to exploit. It was deftly done.

A key issue is Apple's Irish subsidiary, Apple Operations International. See How Apple Sidesteps Billions in Taxes. Another is whether Apple fairly attributes income in a kind of corporate forum shopping. Apple sells huge volume outside the U.S. and keeps substantial cash outside the U.S. too. But as noted in How Does Apple Avoid Taxes?, Apple's Irish deal is a sweetheart one, a kind of nowhere income.

Since repatriating funds to the U.S. would trigger a 35% tax, Apple opted to raise billions in debt financing for share repurchases and dividends. U.S. tax law allows Apple to return capital to shareholders using debt at lower cost than through repatriating its own money.

Companies with IP often consider where it should be located. The Netherlands, Belgium, France, the U.K., Ireland, Switzerland, Spain and even China can be appropriate jurisdictions for patent entities. How do you assess whether revenue is from the IP, manufacturing, or sale?

It comes from all in most cases, and that invites putting the IP where it is taxed at a low rate. The owner may derive income from licensing the IP, selling products or providing services using it. Licenses and sales may be to related parties, unrelated parties or both.

IP off-shoring can significantly reduce a company's effective tax rate. By comparison, individual Americans paying tax at up to 39.6% on their worldwide income might feel they're getting a raw deal.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.